



MANDATORY AUDIT: WHO PERFORMS AUDITS OF PUBLIC COMPANIES ON BELGRADE STOCK EXCHANGE?

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Abstract:

Audit is a systematic process of objective gathering and assessment of evidence related to company's management statements regarding economic activities and events recorded during the reporting period. The purpose of financial statements audit is to build trust of potential users in published financial statements. This is achieved by obtaining auditor's opinion on the compliance of the key elements of financial statements with the relevant financial reporting framework and professional standard. The purpose of this article is to highlight the importance of a mandatory audit, especially for public companies. The research based on a sample of 434 companies listed on the Belgrade Stock Exchange shows that national audit firms perform mandatory audits for nearly 63% of publicly-traded companies, while the remaining number of companies are audited by international audit firms (including the Big 4).

Keywords:

audit opinion, public companies, financial reports, Big 4

INTRODUCTION

In accordance with the Law on Auditing of the Republic of Serbia, the audit of financial statements is a process of review and assessment of financial statements, as well as data and methods applied during their preparation. The main purpose is to obtain „an independent expert opinion on whether the financial statements in all factually significant respects give a true and fair account of the financial position and results of operations of a legal entity in accordance with the appropriate regulations for the preparation of financial statements” (Official Gazette of RS No. 62/2013 and 30/2018, 2019). Therefore, the audit as a science is a set of activities that verify accuracy, truthfulness, completeness and objectivity of presented processes and activities that have been undertaken in a company during the reporting period.

Increasing investments, rising financing and crediting of business systems mostly depend on financial statements created by a business entity management. Companies quoted on the stock exchange have separate function of ownership from the management function. Based on those companies assigned individuals to manage and monitor their business activities. Therefore, the management is fully responsible for the truthfulness and objectivity of financial statements. However, the fact is that both parties, i.e. management and owners (investors) endeavor to maximize their own interests, so the management probably won't always perform in the best interest of owners and investors. Consequently, owners need appropriate supervision over their capital in order to preserve and increase it.

In order to increase a trust of a business entity's trustees in disclosed financial statements, an independent and professional opinion on reliability and credibility has to be obtained. Namely, the auditor is an independent expert whose opinion

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increases a credibility of the information provided within financial statements. An auditor possesses knowledge and skills that can help a company to improve their business, as well as to increase the quality of financial reporting in terms of disclosure and compliance with accounting standards and regulations (Hayes, Schilder, Dassen, & Philip, 2002).

Conditions for a mandatory audit are defined by the national auditing legislation, while general guidelines and frameworks are set by the international professional regulation. Accordingly, article 2. of the Law on Auditing of the Republic of Serbia defines following terms in regard to auditors (Official Gazette of RS No. 62/2013 and 30/2018, 2019):

1. Certified Auditor- is a natural person who passed certified auditor exam, but has not been granted a valid license to perform audits;
2. Licensed Certified Auditor- is a natural person who passed certified auditor exam and possess a valid license to performs audits;
3. Independent Auditor- is a licensed certified auditor possessing a valid license to perform audits as a sole proprietor in accordance with this Law;
4. Auditor of the EU Member State- is a natural person possessing a valid document to perform mandatory audits issued by the competent authority of the Member State;
5. Third Country Auditor- is a natural person possessing a valid document to perform mandatory audits issues by the competent authority of the third country;
6. Group Auditor- is an audit firm that performs mandatory audits of consolidated financial statements;

On the other hand, the literature mentions following levels of auditors (Stanišić, 2014):

1. Younger auditor – is an audit beginner. Younger auditors are entrusted with simple tasks such as inventory, interest calculations, etc. After gaining certain experience in the audit business, they join other auditors to assist them in their field work.
2. Auditor – is a professional who passed certified auditor exam. An auditor is capable of performing audit independently, but under supervision.
3. Supervisor– is a licensed auditor who passed the relevant exam. A supervisor is in charge of the most delicate activities and tasks, as well as implementation of working standards and control of teams involved in audit process.
4. Audit manager– is a licensed auditor in charge of managing a team of auditors, control of supervision, audit planning, etc. Audit managers are usually experts in certain areas, so they act as consultants for professional activities.

5. Audit partners – are certified auditors and owners of audit firms. They manage and represent the audit firm on the market.

A process of financial statements in an audit may differ in terms of methodology and approach of an audit firm. In that sense, international audit firms operating under the license or with the permit of an international audit firm will implement the methodology of those firms. Large audit firms have comprehensive and stabile internal control systems that are a prerequisite for providing high quality audit services. Additionally, the audit methodology and tools used by large audit firms include some extra requirements that go beyond the requirements of the International Auditing Standards, which contribute to improvement of audit quality. Therefore, financial statements in audits done by the Big 4 may give more credibility to disclosed financial statements than the ones done by some non-Big 4 company (Lawrence, Minutti-Meza, & Zhang, 2011). It is important to mention that larger companies are required by the law to hire audit firms employing a bigger number of licensed auditors, so the fact is that Big 4 companies are mostly hired by large and medium-sized companies that have more complex business processes.

The purpose of an audit is to enable auditor to create an opinion based on review of truthfulness and accuracy of company's financial statements and other relevant information, such as whether they are prepared in accordance with generally accepted accounting principles and international auditing standards (State Audit Institution, 2019). The results of financial statements of an audit are presented through the audit report, which ensures its credibility. |Types and varieties of audit will be explained below, as well as the legal framework of the Republic of Serbia regulating mandatory audit and basic conditions for selection and appointment of an auditor. Prior to the conclusion, results of the research regarding participation of national and international audit firms in mandatory audit of public companies listed on the Belgrade Stock Exchange will be presented.

TYPES AND VARIETIES OF AUDIT

Several authors including Hayes, Schilder, Dassen & Wallage (2012), Vasiljević (2012) and Aleksić (2012) list following types of audit:

1. Audit of financial statements – is a complex process of checking and examining business entity's documents in order to obtain an independent expert opinion on fairness and truthfulness of financial position and results.
2. Business audit (operational audit) - is a detailed analysis of all or particular business activities of a company in order to evaluate the success of the



business of the entire company or some of its organizational part. The purpose of an operational audit is to determine the efficiency and profitability of the business in order to identify areas and activities that need to be improved.

3. Compliance audit—is a process of determination whether companies operate in accordance with predefined rules, regulations and policies.

In business entities, the audit can be performed by both employees and external companies, so-called Certified Public Accountant (CPA) firm. In regard to this, there are three basic types of audit, namely:

1. External or mandatory audit— is an independent audit performed by a licensed auditor hired by a client. The aim and purpose of an external audit is to express an opinion on the validity and accuracy of the financial statements based on professional and legal regulations.
2. Internal audit –is an independent audit within a company, whose function is to complete tasks and procedures set by the business entity’s management on a daily basis. Internal audit has a role of a consulting activity, which helps the management to achieve all the goals set by the company.
3. State or budget audit— is an audit of financial reports of public business entities and other public institutions, regulated by specific legal norms. State audit is performed by state auditors. They check relevant financial statements and submit them to the National parliament (Aleksić, 2012). Public sector reviews financial activities of state-owned entities, in order to assess whether they have conducted their business in the best interests of the public and whether standard procedures have been followed in accordance with the requirements promoting transparency and good governance.

When it comes to mandatory or external audit, we need to point out that it is mandatory for companies whose securities are publicly traded, in accordance with the Law on the Capital Markets (Securities Commission of the Republic of Serbia, 2019). The reason is a benefit for potential investors who would like to invest free funds in securities of other legal entities. Namely, they would like to acquire timely and accurate information on the business activities of companies they want to invest in, and appropriate audit of financial statements increases their trust.

TYPES OF AUDIT REPORT

Depending on the opinion expressed, standard and modified audit reports differ. A standard or unmodified report is the most common type of audit report that contains a positive opinion. On the other hand, a modified auditor’s report may contain a qualified opinion, disclaimer of opinion or an adverse opinion.

As mentioned above, within the audit report the auditor expresses his/her opinion, which has to be in accordance with International Standards on Auditing, in one of the forms listed below (Stanišić, 2014), (State Audit Institution 2019), (Petrović, 2010):

1. Unmodified opinion;
2. Qualified opinion;
3. Disclaimer of opinion and
4. Adverse opinion.

Unmodified opinion report refers to accurately disclosed financial statements that give a true and fair view of the financial position and results. This report may also take a form of unmodified opinion with matters of emphasis. On the other hand, when it comes to modified reports, the auditor finds that unsatisfactory audit has been carried out or financial reports have been disclosed with significant errors. Qualified opinion is given in case of relative incompliance of certain aspects of financial statements with accounting principles and frameworks. Such incompliance is of minor significance, so there is no reason for auditor to give an adverse opinion. Disclaimer of opinion is issued when the auditor is unable to gather sufficient audit evidence to form an opinion on disclosed financial statements. The auditor issues an adverse audit opinion when the financial statements contain a large number of significant errors or are completely inaccurate.

In order to get an insight into the current results of mandatory audit for public companies in the Republic of Serbia, a short survey that included all companies from the Belgrade Stock Exchange was conducted. Considering that certain number of companies did not disclose audit reports, the total sample consists of 434 companies. The reporting year is 2017 and the disclosed audit reports of the companies were downloaded from the official website of the Business Registers Agency. The table below shows the results.

The table shows that the largest number of companies received a modified opinion. Considering that, on the developed capital markets, one of the conditions for quoting companies on the Stock market is receiving an unmodified audit opinion, the obtained survey results were not expected. Out of 185 companies that received an unmodified opinion, 54% are reports with unmodified opinion with matters of emphasis.



Table – 1 Audit Opinion Type of Serbian Public Entities in 2017

Audit Opinion Type	Number of Opinions		% in Total Number
Total Unmodified Opinion	185		42.63%
Unmodified Opinion without Matters of Emphasis	86	46.49%	19.82%
Unmodified Opinion with Matters of Emphasis	99	53.51%	22.81%
Total Modified opinion	249		57.37%
Qualified Opinion	154	61.85%	35.48%
Disclaimer of Opinion	84	33.73%	19.35%
Adverse Opinion	11	4.41%	2.54%
Total Audit Opinions	434		100%

Within the total number of companies that received a modified opinion, majority of companies received a qualified opinion (almost 62%). Receiving qualified opinion means that disclosed financial report had a minimal number of significant errors.

Out of total number of survey companies almost 20% received disclaimer of opinion. This fact shows that auditors were unable to collect sufficient auditing evidences to provide their opinion. The last but not the least, even 11 public companies (almost 3%) received an adverse opinion.

MANDATORY AUDIT OF FINANCIAL REPORTS OF PUBLIC COMPANIES IN SERBIA

In accordance to the Law on the Capital Market of the Republic of Serbia, the audit of financial statements of public companies is performed in compliance with the Law on Accounting and Auditing. An audit report has to be signed by responsible person and fully disclosed to the public together with the annual financial statements (Official Gazette RS, No. 31/2011, 112/2015 and 108/2016, 2019).

According to the Law on Auditing, audit of financial statements can be conducted by:

- 1) Auditing firm that has at least one licensed certified auditor as a full-time employee and fulfills the other requirements set by the Law;
- 2) Auditing firm of the EU member state that possesses an audit operating permit in accordance with the Law;
- 3) Auditing firm of the third country that possesses an audit operating permit in accordance with the Law;
- 4) Independent auditor;
- 5) Auditor of the EU member state who possesses a valid license and audit operating permit issued by the relevant institution of the Republic of Serbia. The auditor has to be registered as an entrepreneur in the Republic of Serbia;
- 6) Auditor of the third country who possesses a valid license and audit operating permit issued by the relevant institution of the Republic of Serbia. The auditor has to be registered as an entrepreneur in the Republic of Serbia.

An Auditing firm may perform up to maximum five consecutive audits of annual financial statements for the same public company. Within the same year an auditor may not conduct financial statements audit for the company and provide consultancy services to it, too. In accordance to the Law on Auditing, an auditor has to have the highest professional title in the area of auditing; at least three years of experience in performing audit activities and should be independent from the client.

The audit is performed by licensed certified auditors, employees of the auditing firm, or independent auditors in case they are members of the Chamber of Auditors. An auditing firm or independent auditors may entrust certain tasks within the audit process to other persons employed by the auditing firm. Those other persons are not licensed to perform the audit, therefore their work has to be planned and supervised by a licensed certified auditor. In accordance with the Law on Accounting and Auditing an audit of the regular annual and consolidated financial statements of large legal entities may be conducted by an auditing firm that employees at least four licensed certified auditors on full-time positions, unless otherwise regulated by another law.

Finally, the auditor creates a report and gives an opinion on whether the annual financial statements of the public company have been prepared in accordance with international financial reporting standards, international accounting standards and regulations governing accounting and auditing. The auditor's report and given opinion also provide information about truthfulness and objectivity of presented financial position, business results and cash flows for that year, in terms of all materially relevant matters. An audit report is a report issued by an auditing firm or an independent auditor in accordance with this Law and International Standards on Auditing.

SELECTION AND APPOINTMENT OF THE AUDITING FIRM

In accordance with the Law on Auditing, an assembly shall select and appoint an auditing firm no later than September, 30th of the annual financial year. The exception is audit client that prepares financial statements with the end-year balance on the last day of the business year,



which is different from the calendar one. Such audit clients have to select and appoint an auditing firm no later than three months before the expiry date (Official Gazette of RS No. 62/2013 and 30/2018, 2019).

A significant number of competent auditing firms, namely 64, operate on the territory of the Republic of Serbia (Knežević, Stanišić, & Mizdraković, 2019). However, in order for an auditing firm to perform a mandatory audit of a public company, certain conditions have to be met (Securities Commission Republic of Serbia, 2019), (Official Gazette of RS No. 62/2013 and 30/2018, 2019), (Official Gazette of RS No. 62/2013 and 30/2018, 2019):

1. General criteri that an auditing firm has to fulfill in order to be including into the List are:

- Firm has to operate in accordance with the law governing accounting and auditing;
- Firm has to employ at least two licensed certified auditors on a full-time basis that have at least three years of work experience in performing an external audit of the financial statements, as well as at least five full-time employees involved in auditing process organization;
- Within three months after the end of each business year, the firm shall publish information defined by the Regulations on its website;
- Final condition is that within the last three years the Commission has not rejected an auditing report on financial statements disclosed by the firm nor excluded the firm from the List.

2. Auditing firm of public companies listed on the regulated Stock Exchange has to meet following requirements: the company has to employ licensed certified au-

ditors on a full time basis that have at least three years of work experience in performing an external audit of the financial statements, whereas the number of such auditors should not be less then:

- Three- in case the firm performs audit of financial reports of the public company whose stocks are included into Stock market listing.
- Four - in case the firm performs audit of financial reports of the public company whose stocks are included into List. Additional condition for the firm to be eligible to perform audit is to employ at least ten full-time employees involved in the auditing process organization.

The official list of auditing firms admitted to perform mandatory audit of public companies is published by the Securities Commission. In 2017, total number of 37 auditing firms possessed valid license (Securities Commission Republic of Serbia, 2019). Out of that number, 19 auditing firms (51%) had been established and still operate business in Serbia, whereas their business is not within the scope of international auditing firms. The other half of auditing firms are international ones, out of which four are so-called „Big 4“ companies (one of these companies did not perform audit for any of the sample companies listed in the table below). The table below shows involvement of each of the three categories of audit companies mentioned.

It is obvious that most of the sampled public companies hire national audit firms to perform mandatory audit. The smallest number of companies appoints one of the Big 4 audit firms, and this may be due to the fact that the capital market is insufficiently developed, so the profitability of public companies often cannot afford more expensive audit fees.

Table 2 – Involvement of auditing firms in performing mandatory audit of the public companies

National	Audited Entities		International	Audited Entities		BIG 4	Audited Entities	
	Number	%		Number	%		Number	%
Aca Professional Audit Company	11	4.04%	BDO	5	3.85%	Deloitte	11	34.38%
Društvo za reviziju I&V audit	10	3.68%	BakerTilly Srbija	3	2.31%	EY Serbia	0	0.00%
EuroAudit d.o.o.	23	8.46%	Crowe LLP	1	0.77%	KPMG	17	53.13%
Finodit	65	23.90%	DFK Konsrev	4	3.08%	PWC	4	12.50%
Finrevizija	25	9.19%	DIJ-AUDIT-Revizija	6	4.62%			
Libra Audit	7	2.57%	FinExpertiza	10	7.69%			
Pan Revizija Plus d.o.o.	5	1.84%	Grant Thornton Serbia	3	2.31%			
Privrednisavetnikrevizija	16	5.88%	HLB DST-Revizija	19	14.62%			
Prva revizija	15	5.51%	Kreston MDM Srbija	18	13.85%			



Revizija Plus PRO	16	5.88%	MooreStephens	17	13.08%		
Revizorska kuća Auditing	3	1.10%	Nexia Star	6	4.62%		
Revizorska kuća Auditor	26	9.56%	PKF	22	16.92%		
RoshAudit	8	2.94%	RSM Serbia d.o.o.	9	6.92%		
Sigma Revizija	4	1.47%	UHY Revizija	7	5.38%		
Srbo Audit	16	5.88%					
Stanišić Audit	10	3.68%					
Vincić Revizija	5	1.84%					
KLS Revizija	3	1.10%					
Vizura Invent Revizija	4	1.47%					
Ukupno	272	100%		130	100%	32	100%

CONCLUSION

Financial reports prepared by company's management are a part of the monitoring and controlling process in terms of results of company's business activities. The role of an auditor who possesses certain skills and knowledge is to help the management to improve a business, organization and internal control system. In terms of companies listed on the Belgrade Stock Exchange, survey results shows that national audit firms perform audit for 272 public companies, while international auditing firms (including the Big 4) perform audit for 162 business entities. The reasons for not appointing internationally certified auditing firms (including the Big 4) are different, but crucial ones are high audit fees and underdeveloped market. Public companies listed on the Belgrade Stock Exchange usually receive audit reports with a modified opinion, with a percentage of almost 58%. Further research could go towards an analysis of correlation between type of auditor opinions and auditing firms' features, including a fact whether it is a national or international one.

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